House Ways & Means Trade Subcommittee Hearing
Renewal of MFN Status for China
Statement of U.S. Trade Representative Charlene Barshefsky
June 17, 1997

Mr. Chairman, distinguished Members of the Committee, I appreciate this opportunity to discuss the Administration's policy toward China, in particular, the trade aspects of that policy. On May 29, President Clinton sent to Congress the formal waiver recommending extension of MFN treatment to China for another year. The President's decision to renew normal trading relations with China, MFN status, is based upon his judgment about what is in the national interest of the United States.

President Clinton has repeatedly emphasized that America is and will remain an Asian-Pacific power. In a region where we have fought three wars in the last half-century, our role continues to be vital-- from the stabilizing effects of our diplomatic and military presence, to the galvanizing impact of our commercial ties. As the Administration has said, our commitment to engagement with China is solid because it is solidly based on American interests.

The Administration has implemented a comprehensive policy with China, one which is based on continued engagement on the full range of issues. The reason for that policy is clear: U.S. interests are best served by a secure, stable and open China. How China evolves over the next decades will be of profound importance to the American people. China's emergence as a modern power is a major historical event. Indeed, no nation will play a larger role in shaping the course of 21st-century Asia. Already, China affects America's vital interests across the board. The manner in which we engage China will help determine whether it abides by international norms, and becomes integrated into the international community, or whether it becomes an unpredictable and destabilizing presence in the world. That is why we have pursued a policy with China of engagement. It is the President's judgment that engagement with China, rather than isolation from it, is in the best interest of the American people. Mr. Chairman, we will not achieve China's full integration into the international community by building walls that divide us. The most repressive periods in modern Chinese history did not occur in times of open exchange--they occurred in times of isolation.

While the Clinton Administration policy toward China is one of engagement, let me be clear about what we mean by "engagement." Engagement with China does not mean *ignoring* our differences. It means actively engaging China *to resolve* our differences and it means *protecting our interests* when consultations do not produce results.

The vote on MFN is thus a vote on how best to protect U.S. interests, not an endorsement of China's policies. Engagement is not an end unto itself. Engagement is a means by which we can expand the areas of cooperation with China and deal face-to-face with the Chinese on areas of difference.

China's adherence to international norms is fundamental to advancing the entire range of issues between our two countries. Through dialogue, we have built a record of cooperation on agreements to ban nuclear testings, outlaw chemical arms, and enhance nuclear safeguards. China is a contributor to maintaining stability on the Korean peninsula and bringing North Korea into peace talks. We have a strong bilateral program to combat alien smuggling, narcotics trafficking and terrorism. To protect the global environment, our two governments have worked together to establish the U.S.-China Environment and Development Forum to discuss collaboration on topics including energy policy and sustainable development. And, on human rights, while China's official practices still fall far short of internationally accepted standards in areas ranging from the treatment of political dissidents to the continuing problem of prison labor exports, some progress has been made. China has said that it will sign the International Covenant on Economic and Social Rights. It has invited the International Red Cross to China to discuss prisoner issues. Most recently, Chinese courts overturned the conviction of four dissidents. Much more remains to be done, however. The State Department will discuss these and other related areas of engagement in a moment.

The issue before Congress today concerns a choice--between continuing to engage China and making progress on issues that Americans care about--or isolating <u>ourselves</u> from China by severing our economic and, in turn, our political relationship. Our friends and allies--the global community--will continue to conduct normal relations with China, displacing U.S. interests and diluting U.S. influence.

Let me turn to the trade aspects of the Administration's policy of engagement and why continuing normal trade relations is in the trade and economic interests of the United States. I use the term "normal trade relations" because that is precisely what we are talking about. Most-favored-nation or MFN status is a misnomer. MFN tariff treatment is the standard tariff treatment we accord virtually <u>all</u> governments. This "normal treatment," however, is a critical element of our relationship with China. We cannot determine China's direction, but we can help to influence its direction if we remain fully engaged with China.

<u>Maintaining Normal Trade Relations</u>

As I noted, the U.S.-China relationship is complex and multifaceted. America has a range of issues with China that go far beyond trade. We have a deep and abiding interest in human rights, and are critical when basic international norms are not met. We have continuing concerns in areas ranging from non-proliferation to environmental protection. Trade, however, has played an increasingly central role in our relationship. Just as we should not make apologies *for China*, we should not apologize for our economic interest *in China*.

We cannot ignore the fact that the United States has a significant commercial stake in China. It is the fastest growing major economy in the world, with growth rates averaging more than 10 percent in recent years. Already possessing the world's largest population, by early in the next century, China may have the world's largest economy.

Today, China is the world's tenth largest trading nation and the United States' fifth largest trading partner. U.S. exports to China have quadrupled over the past decade. At least 170,000 Americans owe their jobs to U.S. exports to China.

The Administration has clear goals that it wants to achieve in its trade policy with China. First and foremost, we continue to pursue actively market opening initiatives on a broad scale for U.S. goods, services and agricultural products. U.S. businesses should have access--and the necessary protection for their properties--in China's market, equivalent to that which China receives in the United States. Especially in light of our trade deficit with China, we must see greater balance in our trade relationship--with high growth in our exports to China in areas where U.S. companies maintain a comparative advantage. Second, a fundamental principle of our policy has been working to ensure that China accepts the rule of law as it applies to trade--that is, ensuring that China's trade and economic policies are consistent with international trade practices and norms.

<u>The Trade Relationship</u>

The United States is China's largest export market. U.S. imports from China were nearly $51.5 billion in 1996 (or nearly 25 percent of China's exports to the world). By contrast, U.S. exports of goods to China last year stood at only $12 billion. While the large trade deficit with China is the result of many factors, China's multiple, overlapping barriers to trade and investments are clearly of serious concern.

Despite China's movement away from a centrally planned economy toward a quasi-market economy in recent years, China still maintains one of the most protectionist trade regimes in the world. China appears to be following in the footsteps of other major trading nations in East Asia--maintaining export-led growth while protecting its domestic markets. China's failure to meet fundamental international norms--such as national treatment, transparency, or the right to import or export freely--holds back the U.S. side of the bilateral trade equation and hurts U.S. businesses and workers.

During the past several years, as a result of our bilateral initiatives, China has liberalized its markets for many U.S. products. While U.S. access to China's market is far greater now than it was, U.S. access falls far short of what it should be. As we continue to press China on market access issues, we also intend to work with the Chinese Government in support of its economic reform program.

As I noted, a fundamental principle of our policy has been working to ensure that China accepts the rule of law as it applies to trade--that is, ensuring that China's trade and economic policies are consistent with international trade practices and norms, such as those of the World Trade Organization (WTO). Bilaterally our market access, intellectual property rights and textiles agreements have all been throughly grounded in the GATT and now the WTO. Clearly, the ongoing negotiations over China's accession to the WTO are part of our overall approach of creating an effective framework for our trade relationship.

In this respect, trade cannot be separated from the broader considerations of creating a more open, rules-based society in China. Reforms of China's legal system, institution of new laws and regulations, and notions of due process and transparency all build a better trade relationship and, in part, will spring from that relationship. In the WTO accession negotiations, as in the case of our negotiations on IPR enforcement and other bilateral agreements, we will work together with China's negotiators to create a regime that strengthens the legal system and the rule of law in general.

The United States has pursued an aggressive, but balanced, trade policy toward China. To achieve our goals, we have put together a strong, complementary policy that combines bilateral, regional (APEC) and multilateral initiatives. Rather than severing the economic relationship through revocation of MFN, the Administration has sought, and has achieved, tangible results on market access, intellectual property rights (IPRs) and textiles. We have carefully used targeted trade sanctions as an effective tool to achieve U.S. trade objectives when other reasonable means have been exhausted.

Bilateral Initiatives

IPR Enforcement

In 1995, the United States reached an historic agreement with China on the enforcement of IPRs, particularly copyrights and trademarks, and improved market access for U.S. firms in the computer software, motion picture, publishing and sound recording industries. In the 1995 Agreement, China committed to put a basic structure in place for enforcement of IPRs at the central and provincial level and in the major cities. China also undertook improved Customs enforcement of IPRs at the border and to strengthen the protection for well-known trademarks. We reached this agreement after threatening to impose nearly $2 billion in trade sanctions on China's exports.

Over the next year, we carefully monitored China's implementation of the 1995 Agreement. China created enforcement task forces and embarked on some enforcement efforts. However, overall piracy rates remained extremely high and U.S. companies were frustrated in their efforts to achieve market access. That is why, in May 1996, the Clinton Administration threatened to take action against China for failure to implement satisfactorily China's commitments from the 1995 Agreement.

In June 1996, after substantial verification activities on the part of the U.S. government and U.S. industry, we determined that a critical mass of enforcement actions in connection with the 1995 Agreement had been taken by the Chinese, and sanctions were averted. Among the steps confirmed at that time was the closure of 15 factories engaged in piracy, stepped up police activity, arrests and the imposition of fines for piracy, as well as issuance of regulations to crack down on underground factories and the import of CD presses.

Since June, we have seen continued progress. IPR enforcement is now part of China's nationwide anti-crime campaign. Police are now involved in investigating IPR piracy on a regular basis. A nationwide campaign against pornographic and illegal publications has targeted copyright infringements. Pirates are being arrested and the courts are imposing fines and jail terms on people running “underground,”, i.e., unlicensed, CD factories.

In late 1996, Guangdong Province (a region near Hong Kong that has been a center of pirating activity) launched a major crackdown on underground CD factories. The campaign began with an announcement of a reward of 300,000 RMB (US $37,000) for information leading to the closure of underground plants. According to State Council officials, so far Guangdong has paid out more than 1.2 million RMB. The reward system has met with such a success that it has been extended to include six southern and coastal provinces.

Overall, 39 production facilities not approved by the central government have had their licenses confiscated or have been closed since June. According to U.S. industry sources, the 22 legitimate factories, i.e., those that have been throughly investigated and registered by central government authorities, have turned their attention to domestic production while piracy of foreign sound recordings has dropped dramatically. In all, more than 10 million pirated CDs have been destroyed by Chinese government authorities.

Although we have seen significant improvements in enforcement, serious problems remain. Piracy of computer software continues at high levels. While market access for copyrighted products has improved, particularly with respect to sound recordings, we need to see further substantial improvement so that legitimate products are available to meet market demand. The problem of pirate CD factories also affects Hong Kong. Hong Kong is often used as a point for export of pirated product and importation of CD production line equipment. We have been working with the authorities there to address these problems and expect further progress.

Textiles

In 1994 and in February of this year, the Administration concluded bilateral agreements to achieve fair trade in textile products. The February agreement builds on and improves the 1994 Textiles Agreement with China. For the first time, our bilateral agreement provides for market access for U.S. textiles and apparel into China’s market. China has also agreed to ensure that non-tariff barriers do not impede the achievement of real and effective market access for U.S. textile and apparel exports. Following on cutbacks in China’s textile shipments achieved under the 1994 Agreement, the 1997 Agreement further reduced the overall quota to address enforcement issues.

China has agreed to bind its tariffs at its applied rates, thereby assuring security and certainty for U.S. exporters. In addition, China will lower tariff rates over the 4-year term of the Agreement. For certain high priority products, China has agreed to accelerate tariff reductions so that they are completed within two years.

The issue of illegal transshipments of textiles from China has been a significant concern in the past and the Administration has demonstrated its resolve to act against such imports. In 1994 and 1995, the Administration found and charged transshipped products against China's quotas. In 1996, we triple-charged China's quotas. In the February 1997 agreement, we reduced China's quotas in fourteen apparel and fabric product categories where there had been agreement on violations through transshipment or over shipment. The Agreement also includes procedural measures to improve the bilateral consultation process, including arrangements to implement an "electronic visa" information system to more effectively track textile and apparel shipments. Moreover, a special textiles import safeguard mechanism will remain in effect until four years <u>after</u> the WTO Agreement on Textiles and Clothing has terminated.

<u>Market Access Agreement</u>

Obtaining effective implementation of the October 1992 market access agreement is another example of the Administration's continuing pursuit of market opening. In that Agreement, China committed to make sweeping changes in its import regime: China committed to eliminate import substitution policies, publish its trade laws in an official journal, apply the same testing and standards requirements to domestic products and imports, decrease tariffs on certain products, apply sanitary and phytosanitary measures only on the basis of sound science and eliminate licensing and quota requirements on more than 1,200 products over a 5-year period.

China has taken some significant steps in implementing the 1992 Agreement. China's trade regime is more transparent than previously; China has lowered tariffs on many products and has eliminated well over a thousand non-tariff barriers. While China has removed a substantial number of these barriers, we are concerned with China's tendency to give with one hand and take with the other. In some instances, for example in the medical equipment sector, China has replaced a quota with a tendering and registration requirement, thus impeding market access.

A number of other market access problems remain, in particular for U.S. agricultural products. In the 1992 Agreement, China committed to eliminate unscientific sanitary and phytosanitary restrictions used as barriers to market access. China's implementation of this commitment remains incomplete. Over the last four years, we have reached agreement on measures that permit the importation of live horses; apples from the states of Washington, Oregon, and Idaho; cattle, swine, bovine embryos, and cherries. Just last month, our negotiators completed a bilateral protocol and work plan that will permit exports of U.S. grapes to China. This new market for U.S. grape producers could reach more than $45 million in the next two to three years. China remains a major purchaser of U.S. wheat, corn, cotton, course grains and other bulk products.

Restrictions affecting such U.S. exports as pacific-northwest wheat, stone fruit, citrus, poultry and pork products are not based on sound science and remain in place. This is a particular source of concern. We are engaged in an active work program to resolve these sanitary and phytosanitary restrictions on our exports. I have created the new position of Senior Advisor and Negotiator for

Agriculture at USTR, with responsibility for leading our bilateral efforts to improve market access for this important sector of the U.S. economy.

WTO Accession

The process of negotiating the terms of China's accession to the WTO Agreement is a major focus of our efforts. It is a means not only to expand market access for U.S. exports, tut also to bring China into the international rules-based trading system.

President Clinton has repeatedly affirmed U.S. support for China's accession to the WTO, but only on the basis of commercially meaningful commitments that provide greatly expanded market access and ensure compliance with WTO obligations. At this juncture, while China has evidenced a new seriousness about the negotiations, it has yet to put forward acceptable offers on market access for industrial goods, services and agricultural products. In addition, significant reforms will be needed to bring China's practices into conformity with WTO rules. The timing of China's accession is in China's hands. We are prepared to move as quickly as China, based on serious offers that provide genuine market opening and a means to achieve the balance that is lacking in our trade relationship.

Successful WTO accession would also achieve important broader objectives. Upon accession, China would be required to conform its current trade laws and practices to internationally-agreed rules and base any future laws on the same international norms that apply to the United States and other WTO members. Basic WTO principles, such as publication of all laws and regulations, the right to appeal administrative decisions, application of all of its trade laws uniformly throughout the country, and equal treatment for domestic and imported goods, all fosters the rule of law. Moreover, China's implementation of these basic principles would be subject to dispute settlement based on the same rules that apply to all WTO Members. The United States has used the WTO dispute settlement system successfully against major trading partners, such as Europe, Japan and Canada, as well as against countries such as Korea and Pakistan.

WTO accession would also accelerate economic reforms, moving China toward a more market-oriented economy. WTO accession would require elimination of measures that protect state monopolies, take government out of commercial transactions through limiting the use of price controls and eliminate trade distorting subsidies, quotas and export performance requirements. In short, China would be required to open its market to a broad range of goods and services in areas in which U.S. companies are internationally competitive. We are now engaged in comprehensive negotiations to accomplish this objective. A commercially meaningful accession package would result in tangible gains for U.S. companies and workers.

Effects of MFN Revocation

Revocation of MFN tariff treatment jeopardizes our current and future bilateral and multilateral trade initiatives. MFN revocation would cut U.S. exports to China, increase prices for U.S. consumers and cost jobs in this country. An added factor this year, is the destabilizing affect that MFN revocation would have on Hong Kong.

We estimate that revocation of MFN would increase tariffs on imports from China to a trade-weighted average of about 44 percent, from their current level of about 6 percent. Even accounting for changes in trade flows, revocation would result in U.S. consumers paying approximately $590 million more each year for goods such as shoes, clothing, and small appliances. For manufacturers, the cost of goods made with Chinese components would increase, reducing the competitiveness of their finished goods in domestic and international markets.

If MFN tariff treatment is revoked, China is likely to retaliate against U.S. exports by increasing tariffs on these products and other measures. China has threatened such actions in the past in response to our use of trade sanctions.

U.S. exports to China have nearly quadrupled over the past decade. Those exports support more than 170,000 jobs in the United States. Jobs based on goods exports, on average, pay 13 to 16 percent more than non-export related jobs. Revoking MFN would jeopardize U.S. exports and U.S. jobs, thus transferring those export opportunities and those jobs to Japan, Europe and other competitors.

Revocation of MFN would also derail current bilateral and multilateral negotiations. Instead of engagement, China may, for example, cease bilateral negotiations on sanitary and phytosanitary restrictions on agricultural products and would likely decrease efforts to enforce our bilateral IPR agreements. Moreover, negotiation on WTO accession would stop, creating uncertainty over how China's markets will evolve. In short, we would lose the opportunity to shape the evolution of China's trading system in a manner compatible with international norms and U.S. expectations.

The situation in Hong Kong this year provides another compelling reason for continuing normal trade relations with China. MFN revocation would deal Hong Kong a devastating economic blow and would have a destabilizing effect. Trade is a particularly important part of the economic life of Hong Kong. More than 50 percent of U.S.-China trade is handled through Hong Kong, thus making it highly dependent on continued normal trade relations between China and the United States.

Hong Kong authorities estimate that MFN revocation would slash its trade volume by $20 to $30 billion, resulting in the loss of between 60,000 and 85,000 jobs. Hong Kong's economic strength is one of its chief assets in ensuring its autonomy and viability. Hong Kong leaders, including Democratic Party leader Martin Lee, British Governor Patten, and Anson Chan have spoken out strongly in favor of renewal of MFN. The implication is clear: bilateral trade between the U.S. and China, encouraged by MFN tariff treatment, provides needed stability at a time of dramatic change.

Revoking MFN would not only damage our important and evolving commercial relationship; it would also deny us the benefits of our strategic dialogue. And because China's politics are in flux, especially during the run-up to this fall's Party Congress, the withdrawal of MFN would almost surely strengthen the hand of those in China who have been seeking to fill the country's ideological void with a belligerent nationalism.

Mr. Chairman, as I mentioned earlier, providing MFN tariff treatment is the norm in U.S. trade, not the exception. In every year since 1980, every U.S. President has supported extension of MFN tariff treatment to China. Granting MFN treatment means that China will receive the same tariff treatment as nearly every other U.S. trading partner.

The United States has a long history of providing the same basic level of tariff treatment to other countries and maintaining normal trade relations with the global community. Because MFN is a powerful symbol of America's global commitment to open markets, Congress has enacted into our law a presumption that normal trade relations will exist between us and other countries. Maintaining such relations is vital to a broad array of U.S. interests; maintaining normal trade relations with China is no less vital.

Conclusion

Congress is again faced with a decision whether to pursue a positive agenda for trade and our overall relations with China or to sever our economic relations with that country and isolate ourselves from it. While achieving our objectives through positive engagement and the use of targeted measures is a slow and difficult process, it yields results. MFN treatment should be renewed.